North Carolina Department of Health and Human Services

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The Honorable Beth A. Wood, State Auditor
Office of the State Auditor
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Raleigh, North Carolina 27699-0601

Dear Ms. Wood:

We have reviewed your report on the findings and recommendations that resulted from the Division of Medical Assistance – Performance audit of the Department of Health and Human Services as outlined in Section 10.9A.(a) through (b) of the 2012-2013 North Carolina State Budget. The following represents our response and corrective action plan to the Audit Findings and Recommendations.

SUMMARY OF RESULTS

BUDGET FORECASTING

Budget Forecasting – Finding 1

The Division's budget development and administration practices violate State statutes that have been enacted to ensure agency and legislative accountability for public expenditures.

Recommendations:

1. DMA and DHHS should be required to submit reasonable estimates for all known Medicaid expenditures in their agency budget requests. If expenditures exceed allowable limits, DHHS, the

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Governor, or the General Assembly should take actions to reduce expenditures to stay within spending caps, rather than omit known expenditures from the budget.

***DHHS Response**: The Department partially agrees with portions of the finding details and agrees with this recommendation. DMA agrees that reasonable estimates should be requested for all Medicaid expenditures, and actions to reduce expenditures should be taken. DMA partially agrees with the findings, it should be noted that DMA cannot independently enact changes to services, rates and programs without approvals for CMS and prior notifications to the Native Americans. The process requires that any change be communicated to the Native Americans 60 days prior to submitting a change to the state plan to CMS. Once a change request has been submitted, CMS has 90 days to approve, deny or request additional information. If additional information is requested 90 days for approval, denial or request for additional information begins again once DMA has responded to the original request.*

DMA utilizes history on a monthly and quarterly basis to improve the accuracy of forecasts. DMA prepares a monthly claim forecast and comparison between forecasted actuals and "authorized budgets". Additionally, DMA prepares per member per month (PMPM) reports that compare program aid category expenditures by category of service to prior years and total PMPM by category of service to budget and prior year expenditures. In addition, DMA prepares monthly internal dashboards and ad hoc reports in response to Legislative requests. In SFY 2012 and 2013, DMA initiated a monthly report of progress by CCNC toward achievement of the legislatively approved reduction.

2. DMA's agency request budget should adjust expenditures for all known costs that increase or decrease with fluctuations in caseload, including costs in administrative funds 1101 and 1102. These requests should be accompanied by appropriate documentation.

***DHHS Response**: DMA agrees with this recommendation and partially agrees with this finding, historically, DMA has been ~~told~~ instructed repeatedly that rebasing of funds other than 1310 (expenditures for claims and services) would not be approved. Therefore, the Division was advised not to submit either an expansion request or request for rebase. Many of the budget discussions occur in weekly meetings with OSBM and Fiscal Research.*

3. When DMA perceives that the General Assembly has included unachievable savings in their budgets, DMA should provide OSBM with documentation of this at the beginning of the biennium or fiscal year, along with a forecast of the additional total dollars and State General Fund that will be required to cover this unachievable savings.

***DHHS Response**: DMA agrees with this recommendation and paritally agrees with the finding. DMA did in fact provide the Department, OSBM and Fiscal Research with information regarding the inability to achieve savings included in the budget for SFY 2012-2013 as early as April 2011. Additionally in presentations to the Legislature and Medical Care Advisory Committee on more than one occasion outlined the issues with achieving the budgeted savings.*

4. DMA should discontinue the practice of incurring liabilities for the State at the beginning of the fiscal year because they have overdrawn federal funds in the prior fiscal year to offset State General Fund shortfalls.

***DHHS Response**: DMA does not agree with this finding, it does agree with the recommendation to not incur liabilities, but does not agree with the use of the word "practice" in the recommendation. DMA*

does not and can not make unilateral decisions about budgets, cashflow and "the practice of incurring liabilities" independently. DMA will work with the Department, OSBM and Fiscal Research to manage cash and expenditures as appropriate.

An important that must be kept in context when considering this finding and recommendation is the overall State's budget situation for the last 3 years and the lack of availabilty of funds. The State utilized funds from many sources to meet all required payments and transferred funds from many sources including Medicaid to meet these requirements.

5. Because Medicaid is such a large and complex program with a significant impact on the State budget, DMA may require more oversight than any individual Department Secretary with multiple other divisions and programs can provide. The General Assembly should consider organizational changes that could improve the oversight needed to ensure that the Medicaid program is operated in compliance with legislative mandates.

DHHS Response: *This is a decision that is independent of DMA that the Department, Governor and Legislature must determine. As additional infomation, OSBM prepared a report in 2010 that identified the following issues for consideration:*

1) *Removing Medicaid from DHHS and creating a separate health care/insurance organization that included Medicaid, the State Employees Health Plan and Health Choice.*

2) *Increasing staffing at DMA by 50 to 70 positions*

3) *Conducting a gap analysis to reallocate staff resources by determining proper staff level, required skill sets and adequate pay levels to ensure success of the program*

4) *Outsource Program Integrity to one or more contractors that have the technology and experience needed to increase collections, reduce cost and increase revenue*

5) *Consolidate Medicaid into one physical location*

6) *Institute a form work flow, with electronically or through paper sign off sheets so that the impact of policy changes can be accurately estimated*

7) *Establish a centralized office through which all requests for information are received and all data reported out of the agency are verified and disseminated to improve consistency and accuracy of communications*

8) *Focus on policy changes to improve cost containment. More analysis should be done to ensure the greatest drivers of cost increase and the greatest outliers from other states are the focus.*

<u>Budget Forecasting – Finding 2</u>

The Division's budget forecasting methodology does not allow for reasonable multiyear projections and does not provide an accurate picture of the current year's financial position.

Recommendations:

1. DMA should forecast for all Medicaid funds, and these forecasts should be provided in an agreed upon format to OSBM and Fiscal Research Division at least quarterly.

***DHHS Response**: DMA agrees with this recommendation and partially agrees with the finding.*

2. DMA should formalize its methodology for forecasting revenues.

***DHHS Response:** DMA is unclear of ~~what~~ this references ~~to~~, ~~since~~ this was never presented in previous discussions or documentation provided by the State Auditor. DMA agrees that all processes that could improve forecasting should be evaluated and will pursue clarification from the State Auditor on this recommendation. DMA will work with OSBM and Fiscal Research to ensure that there is understood, agreed to and documented methodology for forecasting revenues.*

3. DMA should maintain a comparison of forecasted expenditures and revenues to actual year end budget performance and subject it to analysis that can improve the ability to project expenditures and revenues.

***DHHS Response:** DMA agrees with this recommendation, consistent with DMA's understanding from it's meeting with the State Auditor and consultants. In the ~~that~~ the substance of this finding was described as comparing forecasts prepared in one period to forecast prepared in subsequent periods to determine the source of changes in forecasting outcomes; as a process for improving forecasting methods. DMA agrees that incorporating this into its forecasting processes would in fact create an opportunity for improvement.*

DMA prepares and has prepared detail analyses every month of variances between actual, forecasts and budget. Prior to July 2012, this was done for only 1310 which accounted for over 90% of the state's Medicaid appropriation in state fiscal year's 2010, 2011 and 2012.

Since July 2012, these analyses have been also prepared for non-1310 funds. DMA partially agrees with finding

4. DMA should prepare a five-year analysis to contribute to the Governor's budget message and should routinely forecast expenditures and revenues for a minimum of three years in the future.

***DHHS Response:** DMA will prepare forecasts as requested by the Department, Governor and Legislature. The tools and processes employed by DMA have the ability to produce forecasts beyond the two year biennium practice. DMA will consider this recommendation in consultation with the parties that utilize forecasts of DMA expenditures and make appropriate changes.*

Budget Forecasting – Finding 3

The Division of Medical Assistance does not appropriately manage Medicaid costs that are subject to agency control.

Recommendations:

1. Because caseload is a significant cost drive for Medicaid, DMA should perform multiyear caseload projections to support multiyear expenditure forecasts, and these forecasts should be tracked against actual caseload growth to evaluate the accuracy of the forecasting methodology.

DHHS Response: *DMA agrees with this recommendation that caseload is a significant cost driver for Medicaid. DMA utilizes the SAS statistical forecasting tool, which currently provides a 2 year forecast of enrollment/caseload. Should it be determined that the Department, OSBM and the Legislature require forecasts beyond the 2 year biennium cycle, DMA will implement an extension of the forecast to accommodate whatever period is requested.*

DMA partially agrees with this findings. Financial forecasting is a basis for management decisions that traditional business utilizes for capital and operational planning. Forecasts for DMA, like traditional business, requires a myriad of assumptions.

The areas where assumptions for Medicaid are required include:

- *Enrollment by program aid category: significantly based on the wide variation in expenditures on a PMPM basis for each of the 14 program aid categories that comprise the Medicaid program. Additionally, this requires assumptions about driving factors in the economy, such as unemployment, migration, birth rates and other causal variables incorporated in the SAS forecasting tool.*
- *Consumption: trends in the utilization of services by category of service*
- *Federal Mandates and Cost Based payments: changes in payment methodologies and rates at the federal level and operating costs in payers where cost is a component or basis for payment under the NC Medicaid program.*
- *Environmental factors: anticipation of cyclical trends in such items as annual flu, hurricanes and other non economic factors that may impact Medicaid spending.*
- *Policy: changes in coverage, objectives and program expectations directed by either the State or Federal mandates.*

These are factors DMA incorporates in the annual and biennium forecasts prepared for the Department, OSBM and the Legislature. The State of North Carolina utilizes a biennium budget cycle for planning that DMA participates in along with all Departments and Divisions within state government.

Monthly, DMA prepares a detailed forecast of claims expenditures based on actual experience and expected trends. This monthly forecast projects the expenditures for the ~~then~~ current state fiscal year (at the time). Quarterly, DMA utilizes the SAS statistical forecasting tool to prepare a forecast of enrollment by program aid category and CCNC network. This tool provides expected enrollment based on statistical methods for the next 2 years.

Prior to SFY 2013, DMA also prepared cash forecasts of other funds beginning in April as part of the year end planning process. Beginning in July 2012, DMA began preparing a weekl~~l~~y cash report of all funds and spending that compares actual to a weekly budget. Monthly DMA is also preparing a forecast of non-1310 funds expenditures in addition to continuing the monthly claims forecasts.

2. DMA should perform a study to evaluate reimbursement methodology reform which should have a goal of establishing stable reimbursement methodologies that do not increase automatically, but are only increased by actions approved by the General Assembly.

DHHS Response: *DMA agrees with this recommendation that payment reform is a critical issue for the NC Medicaid program. The reform should include the design of a Medicaid program that defines the health outcomes and objectives of the state, ~~then~~ including a payment system that supports the achievement of those goals. DMA partially agrees with this finding.*

3. The State of North Carolina should engage medical researchers to perform a scientifically valid study based on actual data to determine whether the CCNC model saves money and improves health outcomes.

DHHS Response: *DMA annually engages a national actuarial consulting firm with extensive experience in the health care and health insurance industries to apply actuarial science to determine what savings have occurred as a result of the CCNC program. DMA also participates in the HEDIS report, which is used by HMO's and Health Insurance companies nationally ~~to~~ in comparinges clinical outcomes and processes. DMA will consider this recommendation as a part of it's annual review of CCNC performance. DMA partially agrees with this finding.*

4. Actions should occur, probably from outside the agency, to enforce a change in Division organizational culture to provide a focus on a health insurance perspective that encourages cost containment in an environment of increasing medical services and expanding payments to providers.

DHHS Response: *DMA agrees with this recommendation~~;~~, however, the recommendation should be inclusive of the Executive and Legislative Branches of the NC State Government. Establishing a clearly defined role for the NC Medicaid program as a~~n~~ health insurance program, rather than merely an government entitlement program or a jobs engine for the NC economy, is the first step.DMA partially agrees with this finding.*

Budget Forecasting – Finding 4

DMA failed to comply with a legislative mandate to eliminate inflationary increases for nursing facilities.

Recommendations:

The 2011–2013 budget, as reported in the Senate Appropriation Committees substitute for HB 200, included Item 52 for the DMA budget which "Eliminates automatic inflation increases for Medicaid providers. The Division of Medical Assistance is not to authorize any inflationary increases to Medicaid provider rates during the 2011-13 biennium, except as provided for in Section 10.43." Following the close of fiscal year 2011, DMA reported to OSBM on the composition of their General Fund operating shortfall. The Division stated that Item 52, which HB 200 projected to save $62.9 million in 2012,

failed to reach its target by $36 million. Included in the $36 million shortfall was $12.9 million that was attributed to "DHHS Decision."

***DHHS Response**: The Department disagrees with the finding and recommendation. The reimbursement system provides for a quarterly adjustment in each nursing home's direct care rate for changes in average "acuity" case mix. This change will increase or decrease the rates for the subsequent quarter.*

The rebase is ~~founding~~ founded on enrollment, changes in consumption and changes in rates. The first element is developed at a macro for each program aid ~~category~~,category; the second is unique to each category of service and reflects changes in the proportion of the enrolled population access individual service. The final element quantifies the impact of reimbursement systems that result in increases or decreases in rates that are not controlled by the budget approval process, without a change in the reimbursement system and State Plan.

In the case of nursing homes, the base rates assume the current cost per member per month (PMPM). Changes in cash mix in the upcoming year will increase or decrease the PMPM rates. The rebase attempts to assign a value to the expected changes in case mix based on history. Therefore, without a change in the State Plan, the reimbursement system will allow for changes in direct care rates based on changes in case mix, that were included in the rebase under the section entitled "inflation".

The case mix index (CMI) is the only acuity base factor in the rate system for nursing home payments. Freezing or eliminating the CMI would result in nursing homes not being reimbursed based on acuity of their patients. Additionally, there has not been an inflationary adjustment to the Market Basket Index used in nursing home rates in least 3 years. The State Auditor incorrectly states that the base year for nursing homes "usually moves forward each year" and that "adjusted costs receive an inflationary adjustment each quarter based on the Skilled Nursing Facility Market Basket published by Global Insight". The State Auditor also incorrectly states that the Direct Care Ceiling is set at 102.6%, it is currently set at 100%.

ADMINISTRATIVE FUNCTIONS

Administrative Functions – Finding 1

The Division has consistently exceeded budgeted amounts for contracted administrative costs and interagency transfers due to an apparent lack of oversight.

Recommendations:

Beginning in SFY 2013, DMA began tracking contract expenditures to date against total claimed amounts over the term of individual contracts to identify cases where no purchase order is on file, no current claim is in NCAS or the amount is questionable, or the contract is over budget. As a result, three months into SFY 2013, DMA discovered it was already over its certified budget for contracts. While DMA has taken a step in the right direction by tracking costs against certified budget limits, DMA needs to ensure expenditures do not exceed certified budgeted amounts.

***DHHS Response:** The Department agrees with the finding and recommendation in part. DMA agrees with this recommendation in concept, however, the process has to begin with an approval process that*

realistically accounts for all changes in baseline expenditures. Contracts have to be rebased annually to account for changes in enrollment and other programmatic changes that ~~we~~ are driven by the budget approval process.

DMA cannot unilaterally expend funds beyond the budgeted amounts. Contracts are entered into within the states contract management system with approved amounts, that controls when maximums will be exceeded; and preclude the expenditure of funds beyond that amount without appropriately approved budget revisions from the Department and OSBM. DMA has repeatedly been told that it cannot rebase contract funds, to account for expenditures that will be impacted by enrollment and consumption.

Administrative Functions – Finding 2

Other Department of Health and Human Services (DHHS) division administrative spending is not controlled by DMA and is not sufficiently monitored by DHHS to ensure proper drawdown of federal funds.

Recommendations:

DHHS and DMA need to ensure that proper measures are in place to monitor other divisions' Medicaid spending. Interagency memorandums of understanding (IMOU) or cost allocation plans (CAP) should address the Medicaid program costs being necessary for the proper and efficient administration of the Medicaid State Plan and not the responsibility of a non-Medicaid program.

***DHHS Response**: The Department agrees with the finding and recommendations. DMA provides a pass-through function for other DHHS Divisions to appropriately access federal Medicaid matching funds for administrative functions. Other Divisions with administrative services that support the Medicaid program record expenditures in the NCAS to draw federal funds. The Cost Allocation Branch of the Controller's Office, in conjunction with Division Budget Offices, maintains comprehensive cost allocation plans (CAP) to ensure accurate and allowable allocations to the Medicaid program. The CAP's are submitted to the U.S. Division of Cost Allocation for distribution to Federal partners including CMS for approval. Expenditures that are eligible for Medicaid federal match are included on the CMS 64 based on amounts recorded in NCAS.*

DMA does not directly audit other Divisions' expenditures for accuracy. The CMS Auditors, based at DMA on behalf of CMS, may perform audits of expenditures. The North Carolina State Auditors prepare an annual report of all findings that DMA utilizes to implement process and policy changes in accordance with CMS guidelines and regulations. There have not been findings reported in the last three years on the CMS 64, based on the State Auditors audit program reports.

Administrative Functions – Finding 4

DMA does not have a cost allocation plan for appropriately allocating indirect expenditures and tracking expenditures eligible for increased federal funding.

Recommendations:

DHHS should reassess their conclusion that a DMA CAP is not necessary. A DMA CAP would serve to allocate costs to all benefiting programs, especially NCHC, as well as support the allocation of Medicaid administrative costs to activities with increased FFP.

***DHHS Response**: The Department agrees with the finding and recommendation. DMA agrees that the State should ensure that all expenditures eligible for a federal ~~match,~~match should be matched at the highest appropriate rate.*

Other Divisions with administrative services that support the Medicaid program record expenditures in the NCAS and to draw federal funds. The Cost Allocation Branch of the Controller's Office, in conjunction with Division Budget Offices, maintains comprehensive cost allocation plans (CAP) to ensure accurate and allowable allocations to the Medicaid program. The CAP('s) are submitted to the U.S. Division of Cost Allocation for distribution to Federal partners including CMS for approval. Expenditures that are eligible for Medicaid federal match are included on the CMS 64 based on amounts recorded in NCAS.

If you need any additional information, please contact Monica Hughes at (919) 855-3720.

Sincerely,

Dr. Aldona Wos

AW:~~mr~~jmh

cc: Dan Stewart, Assistant Secretary for Finance and Business Operations
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